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TAKING FROM PETER TO PAY PAUL: 1985 JAPANESE FISCAL POLICY

Summary

Austerity has been the keystone of Japanese fiscal policy since Prime Minister Yasuhiro Nakasone entered office in late 1982, a direction clearly reflected in the fiscal 1985 budget. Mr. Nakasone was successful in defending his austerity policies during the 1982-83 economic slowdown, arguing that a retreat back to Keynesian "pump priming" would harm long-term growth. The economy's rebound in the second half of 1983 and throughout 1984 temporarily hushed the prime minister's domestic critics. As the economy has slowed and foreign criticisms of Japan increased, the fiscal debate has surfaced again but in a more sophisticated manner.

In addition to the usual clash between advocates of loose and tight spending policies, a battle over priorities has developed. In the face of rapidly mounting debt-related expenses and a projected leap in social security costs, government and industry leaders are reassessing the current mix of spending with a view toward invigorating the private sector. This debate, perhaps even more than the fight over austerity, will have important economic, social and political consequences.

Overall Fiscal Growth

Outlays - A close look at the two principal Japanese budgets over the past six years reveals the influence of belt-tightening policies. Growth of overall general account and fiscal investment and loan program (FILP) outlays

has been sharply reined in (see Tables 1 and 2). There is a clear break in growth rates after fiscal 1983, the first year in which Mr. Nakasone controlled the fiscal levers. If interest on the national debt and mandatory transfers to local governments are taken out, the decline in discretionary spending that remains is even more pronounced (see Table 3).

Revenues - The drive to balance the budget also has an impact on government receipts. Reducing the amount of bonds issued to finance current general account outlays is a pillar of the prime minister's policies. The accelerating shrinkage of bond issues highlights this point, and has pushed down the deficit from 25 percent of total outlays in FY 1984 to 22 percent in FY 1985. Conversely, taxes are expected to provide 73 percent of total receipts in the current year, up from 68 percent last fiscal year. A similar picture can be seen in the sources for FILP expenditures: government bonds and borrowing have fallen to zero from 31 percent in the space of three years.

The Bottom Line - From an aggregate standpoint, Mr. Nakasone's austerity drive has been quite successful. But what has been the impact on the economy? Reviewing national account statistics for the past several years shows that the public sector has certainly reduced its share of the nation's output of final goods and services. Current government outlays increased more quickly than overall GNP in only one of the past six years and the growth of public-sector fixed investment was also positive just once during the same period. As such, Mr. Nakasone would find it hard to claim that his fiscal policies directly aided the economic recovery. He might assert that cutting back government spending provides a better environment for growth, but even this is doubtful given the country's abundant private savings. He may be preparing the country to meet future fiscal crises, but his policies have little positive impact on current economic activity -- and may even be a slight drag. Hence the debate over fiscal priorities, which requires a closer look at past, present and future expenditures and revenues.

Robbing Peter to Pay Paul

The prime minister has been trying to support his tight-fisted approach by claiming that the cuts are as evenly distributed as possible. It turns out, however, that they are not very even at all. There are consistent winners and losers in the Nakasone budgets, as a closer examination of Tables 1 and 2 reveals. This is most true of the FY 1985 budget, where the ceiling on total discretionary expenditures was held constant and resources were shuffled among line items to yield significant growth for some and continued shrinkage for others.

Spending for defense and foreign aid are the only two discretionary categories that have enjoyed consistent growth. The reasons for this are clearly political: Tokyo's pledges to promote third-world development and improve its defense contribution are being backed up with yen. Defense contractors obviously benefit, as do Japan's less developed partners. The annual increases, however, have been greater than GNP growth, forcing cuts in many domestically important categories.

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The most politically painful of these is the rapid reduction in monies for public works projects. Almost no line items within public works escaped the axe during the past two fiscal years. The drop is most shocking in disaster relief projects, this despite boosts from supplementary budget appropriations. The initial figure for FY 1984 was raised by 91 percent, yet a drop of 46 percent was recorded from FY 1983. The food price support program is another sacred cow that has been sent to the slaughterhouse: it is getting smaller, faster every year.

A final area that could prove painful is funds for small business. Although smaller enterprises pack less political punch individually, they employ the majority of Japan's workers, making them economically and politically important. Tokyo is advocating reliance on individual initiative and entrepreneurial spirit rather than government help for small businessmen, an approach that may not meet the majority's needs. The liberalization of Japanese capital markets may be of more use to small firms than Tokyo's ambitious plans. Even expenditures for education and science and technology, two of the prime minister's priorities, have been tightly restrained.

Other categories that show moderate overall changes often mask deep cuts or big increases in particular components. This finetuning is best exemplified by outlays for social security: the 2.7 aggregate rise shields a 5.8 percent increase in social insurance and a 5.1 percent decrease in public assistance. In any case, losers easily outnumber winners in this version of "robbing Peter to pay Paul."

And Reaching Deeper into Everyone's Pockets

In addition to the tight clamp on spending, the prime minister has pushed hard to reform the revenue structure. As mentioned earlier, reducing dependence on new issues of government bonds is a priority that forces taxes to rise since the decrease in the deficit is not matched by a fall in spending. Unlike the U.S. tax system, the Japanese government makes marginal adjustments in the national and local tax codes every year. These annual tax reforms usually take the form of altered commodity taxes and investment incentives, but can involve major income tax reductions, as in FY 1984 (see Appendix).

The changes proposed for fiscal 1985 national taxes hit corporations almost exclusively. Coming on top of FY 1984 increases in corporate income tax rates, there is no question as to whether individuals or businesses shoulder more of the tax burden. The share of total tax revenues paid by corporations has risen from 29 percent in FY 1981 to an estimated 33 percent in FY 1985. Personal income taxes will account for approximately 36 percent of total tax revenues this fiscal year, down from 40 percent in FY 1982. Compared with U.S. figures of 45 percent for individuals and 9 percent for corporations in FY 1985, it is easy to understand why Japanese business leaders have been clamoring for tax reform.

Dissatisfaction with the current tax structure is not limited to corporations, however. The majority of the population considers the current system to be unfair, not because of skewed statutory rates but because of non-uniform collection methods. Taxes are deducted from salaried workers' wages by the employer, insuring full compliance. For self-employed workers and

farmers, who still account for a major portion of the workforce, a system of voluntary income reporting and self-tax assessment is the law. It is no wonder that tax avoidance is low among the first group but high among the second.

Therefore, the pressure for major tax reform is growing due to individual and corporate unhappiness and the demands of deficit reduction. The solution raised most often by Mr. Nakasone and Finance Minister Noburo Takeshita is the introduction of a large indirect tax modeled after the value-added tax (VAT) levied by European countries. A tax collected at every stage of the production process has the advantage of raising a large amount of revenue, but imposes a larger administrative burden on manufacturers and may not result in progressive effective tax rates. To balance the increase in prices that would almost certainly result from a VAT, the Finance Ministry proposes reductions in both individual and corporate tax rates as well as uniform reporting and collection methods.

The Ministry of Finance is also implementing an attack on tax loopholes. It is trying to toughen the regulation of tax-free personal savings accounts and wants to crack down on the accounting practices of multinational corporations.

There is broad-based support for tax reform but no consensus on what the reforms should be. The government has been stoking the fires heating the tax debate by issuing a grim medium-term fiscal outlook that shows a widening gap between outlays and revenues if no major new taxes are instituted (see Table 4). The government has initiated a one-year study of a VAT system and hopes to begin making major changes next fiscal year. Opposition parties are quite cautious about prospects for adopting major reforms, partly because they have no alternative policies but also because they have not been able to gauge public reaction to the proposal accurately. The debate is becoming more refined, however, as policymakers discuss the potential and priorities of the Japanese economy.

Is Austerity Alone the Answer?

Despite all the commotion over Secretary of State George Shultz's suggestion that Japan adopt a stimulative fiscal policy (see JEI Report No. 16B, April 26, 1985), the debate over whether austerity is the proper policy course has been settled mostly in its favor. Although a few major political figures, including Economic Planning Agency head Toshio Komoto, still believe that a Keynesian stimulative fiscal policy can be pursued without adverse price consequences, the mainstream of thought remains solidly behind the prime minister's drive to balance the budget.

Mr. Nakasone's argument is that rapidly ballooning debt service costs and maturing debt threaten the future prosperity of Japan. The country must break its addiction to deficit spending or face being overwhelmed by interest payments in the next decade. Coupled with across-the-board limits on spending and borrowing, deregulation of goods and capital markets as well as privatization of the large public monopoly corporations will unleash the energies of private enterprise and assure steady growth, the prime minister maintains. Japanese citizens have accepted his message that belt-tightening today will assure a prosperous tomorrow.

The problem is that they may be following the concept too rigidly. Consumer spending, which still accounts for the majority of GNP, has remained sluggish even while the economy has rebounded. This, plus declining government fixed investment and current spending, has meant that growth has been export-driven. Tokyo's fears that this would exacerbate trade frictions have proven accurate and given ammunition to advocates of a positive fiscal policy.

The Nakasone cabinet faces additional pressures from within the Liberal Democratic Party (LDP). Party members who represent districts that rely on public works projects have been squeezed by spending limits. There is general concern that the spending cuts will endanger the pork-barrel politics that have helped keep the party in power. Finally, there is general unhappiness with the quality of life obtainable by the average citizen: the people responsible for making Japan the second largest industrial economy have not reaped commensurate benefits in terms of social infrastructure. For all these reasons, policy-makers are now looking beyond a simplistic austerity program to one that involves reordered priorities and a new kind of government involvement.

Reordered Priorities

A mid-1984 proposal by LDP executive council chairman Kiichi Miyazawa to devote more resources to social and economic infrastructure helped crystallize the debate over priorities. Although the "asset doubling" plan was meant mostly to boost his fortunes in the prime ministerial elections (see JEI Report No. 40B, October 19, 1984), it has nonetheless generated considerable debate over the wisdom of uniformly cutting spending (see JEI Report No. 17B, May 3, 1985).

Briefly, the Miyazawa proposal would increase public investment in infrastructure, such as roads, sewers and parks, while simultaneously pursuing administrative reform, which encompasses market deregulation and public company privatization. The resulting increase in demand would push real economic growth up to 5 to 5.5 percent annually for the next ten years and improve the quality of life. This compares favorably with current government estimates of sustainable real annual growth of 4 to 4.5 percent. The proposal does not neglect the deficit problem, but relies on growth to provide enough tax revenues to meet future needs. As such, Mr. Miyazawa has taken a page from President Reagan's book by offering the Japanese a more optimistic vision of the future as well as the prospect of an immediate improvement in economic conditions.

The proposal brings up two fundamental questions about the Japanese economy: what is the maximum sustainable level of growth; and what is the order of public priorities? The growth debate is reminiscent of the 1960s when the economy easily outperformed government estimates. Mr. Nakasone's camp advocates moderate growth, arguing that supplies of resources and marketplaces for final goods have changed significantly from earlier decades. Others say that by focusing on its many unmet domestic needs, Japan can attain higher rates of growth, although not the 10 percent jumps recorded in the 1960s. There is even a zero-growth camp, which points to limited natural resources as a reason for no growth and calls for a complete reevaluation of spending priorities.

In terms of priorities, Mr. Nakasone has indicated his preferences despite his even-handed rhetoric -- defense and foreign aid have received consistent increases at the expense of nearly everything else. The "asset doubling" plan is equally emphatic in its praise of government investment in social and economic infrastructure. The government is certainly the only economic actor able to provide a significant increase in roads, sewers and similar facilities, but again the question is who will pay and how fast should the public sector invest?

Conclusion

Japanese fiscal policy remains on a course of reduced spending and borrowing. Its direct impact on economic growth, therefore, is likely to remain small. Monetary and regulatory reform are likely to have a greater impact in the remaining 18 months of Mr. Nakasone's prime ministership.

The seductive call of "asset doubling" presents the prime minister with a major challenge, however. The evolving debate over priorities will determine spending patterns that will have major domestic and international consequences. Equally important, it will influence who will head the government if Mr. Nakasone cannot win a third term. The attention to fiscal policy, therefore, is greater than it has been for several years. Not only does this attention come from the Japanese people, but also from the capitals of Japan's trading partners. Mr. Nakasone's response to this evolving debate will receive close inspection in the months to come.

For further information, contact Jon Choy.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

JEI Report will not be published May 31 because of the Memorial Day holiday. The next issue will appear June 7, 1985.

Table 1: Japan's General Account, FY 1980-FY 1985

(in billions of yen and percentage change)

	FY 1980 (revised)		FY 1981 (revised)		FY 1982 (revised)		FY 1983 (revised)		FY 1984 (revised)		FY 1985* (initial)	
Total Expenditures	Y43,681.4	10.1%	Y47,125.4	7.9%	Y47,562.1	0.9%	Y50,839.4	6.9%	Y51,513.4	1.3%	Y52,499.6	3.7%
Social Security	8,264.4	8.1	8,867.6	7.3	9,141.6	3.1	9,231.3	1.0	9,231.0	-0.0	9,573.6	2.7
Public Assistance	956.3	3.7	992.3	3.8	1,080.6	8.9	1,129.7	4.6	1,139.4	0.9	1,081.5	-5.1
Social Welfare	1,388.2	12.5	1,508.2	8.6	1,603.6	6.3	1,917.5	19.6	1,999.2	4.3	2,004.2	0.3
Social Insurance	5,130.6	8.7	5,566.8	8.5	5,658.2	1.6	5,378.9	-4.9	5,347.9	-0.6	5,658.4	5.8
Health Service	410.2	4.9	418.3	2.0	425.6	1.7	435.4	2.3	467.0	7.3	462.1	-1.0
Unemployment	379.1	0.5	382.1	0.8	373.7	-2.2	369.8	-1.1	367.5	-0.6	367.3	-0.0
Education and Science	4,601.4	6.4	4,821.6	4.8	4,832.6	0.2	4,834.3	0.0	4,866.5	0.7	4,840.9	0.2
Compulsory Education	2,024.3	7.3	2,168.4	7.1	2,220.5	2.4	2,254.5	1.5	2,302.6	2.1	2,357.5	2.4
Transfer to School Account	980.8	5.9	1,014.3	3.4	1,015.5	0.1	1,015.6	0.0	1,071.7	5.5	1,062.7	-0.8
Science Promotion	351.8	1.5	370.7	5.4	381.8	3.0	392.0	2.7	410.8	4.8	381.6	1.3
School Facilities	622.3	8.1	583.0	-6.3	528.8	-9.3	489.8	-7.4	427.3	-12.8	385.1	-9.9
School Aid	541.7	3.3	594.5	9.8	595.2	0.1	592.0	-0.5	567.9	-4.1	570.3	0.4
Student Loans	80.5	22.0	90.6	12.6	90.8	0.2	90.3	-0.5	86.2	-2.3	83.8	-2.8
National Debt Service	5,491.6	25.5	6,654.2	21.2	6,906.9	3.8	8,167.5	18.3	9,155.1	12.1	10,244.2	11.7
Pensions	1,639.9	9.3	1,803.0	9.9	1,891.7	4.9	1,890.0	-0.1	1,885.8	-0.2	1,863.7	-1.2
Civil Servants	130.7	3.8	136.1	4.1	135.4	-0.5	132.7	-2.0	128.2	-3.4	124.8	-2.7
Veterans	1,352.9	9.7	1,508.5	11.5	1,590.1	5.4	1,603.6	0.9	1,601.1	-0.2	1,578.7	-1.4
Administrative Costs	9.4	1.7	10.0	6.5	10.3	3.4	10.6	2.3	10.5	-0.9	10.3	-1.7
War-bereaved Families	146.9	11.7	148.4	1.0	155.9	5.0	143.1	-8.2	146.0	2.0	149.9	2.7
Local Finance	7,828.8	17.5	8,722.6	11.4	7,976.4	-8.6	7,672.9	-3.8	9,219.0	20.2	9,690.1	5.0
Local Allocation Tax	6,952.1	17.3	8,039.6	15.6	7,535.2	-6.3	7,315.1	-2.9	9,036.1	23.5	9,690.1	6.8
Special Grants	379.5	**	130.6	**	0.0	**	2.0	**	0.0	**	0.0	**
Interest Support	497.2	37.9	552.5	11.1	441.1	-20.2	355.8	-19.4	182.9	-48.6	0.0	**
Defense	2,266.5	8.3	2,429.1	10.0	2,566.6	3.0	2,761.0	7.6	2,934.6	6.3	3,137.1	6.9
Public Works	6,801.0	2.1	7,001.2	2.9	7,281.3	4.0	7,224.3	-0.8	6,883.5	-4.7	6,368.9	-2.3
Erosion, Flood Control	1,105.0	-0.3	1,107.4	0.2	1,106.4	-0.1	1,107.4	0.1	1,098.5	-0.8	1,082.6	-1.4
Road Improvement	1,920.0	-1.8	1,901.8	-0.9	1,891.9	-0.5	1,893.3	0.1	1,899.9	0.4	1,826.0	-2.5
Harbors, Airports	528.6	0.3	523.6	-0.9	522.6	-0.2	524.1	0.3	519.8	-0.8	511.8	-1.5
Housing	802.3	12.2	843.0	5.1	877.9	4.1	894.3	1.9	915.0	2.3	757.7	-1.1
Living Environment	966.5	0.8	985.8	2.0	987.2	0.1	988.2	0.1	980.3	-0.8	970.3	-1.0
Agriculture	897.8	0.1	900.0	0.2	899.2	-0.1	900.0	0.1	891.9	-0.9	878.9	-1.5
Forest Roads and Water	180.3	0.6	180.7	0.2	178.4	-1.2	177.1	-0.7	173.2	-2.2	169.6	-2.1
Adjustment Reserves	13.1	-10.0	11.8	-10.0	11.7	-0.3	11.4	-3.1	10.9	-3.7	10.7	-2.2
Disaster Reconstruction	387.6	25.7	547.2	41.3	806.1	47.2	728.4	-9.6	394.0	-45.9	161.3	-21.8
Economic Cooperation	381.9	13.1	425.1	11.3	474.9	11.7	498.2	4.9	543.9	9.2	586.3	7.8
Small Business Measures	242.7	4.0	248.1	2.2	244.3	-1.5	238.9	-2.2	229.2	-4.1	216.2	-5.7
Energy Measures	424.9	31.9	496.2	16.8	559.3	12.7	557.4	-0.3	603.2	8.2	628.8	4.2
Food Price Supports	955.5	-2.7	1,014.1	6.1	1,005.5	-0.9	917.2	-8.8	813.2	-11.3	695.4	-14.5
Miscellaneous	4,432.8	6.1	4,478.3	1.0	4,451.0	-0.6	4,383.9	-1.5	4,354.9	-0.7	4,324.5	-1.0
Others	0.0	**	0.0	**	0.0	**	2,252.5	**	125.3	**	0.0	**
Reserves	350.0	**	164.2	**	230.0	**	210.0	**	170.0	**	350.0	**
Total Revenues	43,681.4	10.1	46,788.1	7.1	47,562.1	1.7	50,839.4	6.9	51,513.4	1.3	52,499.6	3.7
Tax, Stamp Revenues	27,145.0	16.0	31,831.6	17.3	30,498.0	-4.2	31,902.0	4.6	34,835.0	9.2	38,550.0	11.4
Monopoly Profits	783.3	30.5	778.8	-0.6	761.8	-2.2	1,004.2	31.8				
Public Enterprise Receipts	10.0	32.9	12.2	21.8	14.4	17.7	15.1	5.1				
Sale of Public Properties	48.3	15.9	72.9	51.1	67.3	-7.7	82.7	10.3	3,414.9	-30.9	2,269.6	-32.3
Miscellaneous	1,076.4	4.3	1,474.6	37.0	1,854.6	25.8	3,843.3	107.2				
Public Bonds	14,270.0	1.6	12,900.0	-9.6	14,345.0	11.2	13,790.0	-3.9	12,865.0	-6.7	11,680.0	-7.9

*Percentage changes for FY 1985 are based on the initial budget for FY 1984.
**Cannot be calculated or meaningless.

Source: Ministry of Finance

Table 2: Uses and Sources of Japan's Fiscal Investment and Loan Program Outlays, FY 1980-FY 1985

(in billions of yen and percentage change)

	FY 1980		FY 1981		FY 1982		FY 1983		FY 1984		FY 1985	
Total Outlays	Y18,179.9	8.0%	Y19,489.7	7.2%	Y20,288.8	4.1%	Y20,702.9	2.0%	Y21,106.6	1.9%	Y208,58.0	-1.2%
Housing	4,761.9	10.6	5,111.4	7.3	5,130.1	0.4	5,304.1	3.4	5,289.5	-0.3	5,289.3	-0.0
Water Works	2,571.7	7.4	2,716.3	5.6	2,863.2	5.4	2,764.8	-3.4	3,007.5	8.8	3,280.9	9.1
Welfare	628.0	-2.2	658.4	4.8	701.3	6.5	652.0	-7.0	637.9	-2.1	595.7	-6.6
Education	808.9	-2.6	794.3	-1.9	762.8	-3.9	783.0	2.6	777.1	-0.8	745.3	-4.1
Small Business	3,400.4	17.0	3,825.2	12.5	3,905.9	2.1	3,942.2	0.9	3,968.3	0.7	3,764.4	-5.1
Agriculture	885.9	3.9	916.6	3.5	906.8	-1.1	963.0	6.2	1,034.8	7.5	890.6	-13.9
Land Conservation, Disasters	312.0	35.7	276.6	-11.2	310.2	11.9	332.5	7.4	379.1	13.8	472.8	24.7
Roads	1,031.4	3.1	1,182.6	14.7	1,472.6	24.5	1,583.7	7.5	1,711.7	8.1	1,826.4	6.7
Transportation and Communication	1,743.7	0.0	1,953.8	12.0	1,949.0	-0.3	1,924.6	-1.2	1,887.6	-1.9	1,763.4	-6.6
Regional Development	469.4	11.3	445.9	-5.0	538.1	20.7	511.4	-5.0	500.0	-2.2	511.2	2.2
Industry and Technology	547.3	98.0	593.6	8.5	635.6	7.1	626.2	-1.5	620.3	-0.9	603.3	-2.7
Foreign Trade and Economic Cooperation	1,019.3	-2.9	1,005.0	-1.4	1,113.2	10.8	1,315.4	18.2	1,292.8	-1.7	1,114.7	-13.8
Total Revenues	20,679.9	12.8	22,989.7	11.2	23,788.8	3.5	24,402.9	2.6	24,706.6	1.2	25,858.0	4.7
Industrial Investment Special Account	16.9	-41.9	18.9	11.8	18.9	0.0	5.2	-72.5	4.8	-7.7	31.4	554.2
Trust Fund Bureau Fund	17,389.4	14.7	19,480.2	12.0	19,568.9	0.5	19,135.3	-2.2	18,905.2	-1.2	20,029.0	5.9
Postal Savings	7,900.0	9.7	8,900.0	12.7	7,900.0	-11.2	7,900.0	0.0	6,900.0	-12.7	6,400.0	-7.2
Pensions	3,300.0	24.5	3,900.0	18.2	4,300.0	10.3	4,100.0	-4.7	3,850.0	-6.1	3,950.0	2.6
Payments, etc.	6,189.4	16.4	6,680.2	7.9	7,368.9	10.3	7,135.3	-3.2	8,155.2	14.3	9,679.0	18.7
Postal Life Insurance Fund	1,692.0	8.5	1,890.0	11.7	1,981.0	4.8	2,354.4	18.8	2,586.6	9.9	2,587.6	0.0
Government Guaranteed Bonds and Borrowings	1,581.6	0.2	1,600.6	1.2	2,220.0	38.7	2,908.0	31.0	3,210.0	10.4	3,210.0	0.0

Note: All figures are based on initial budgets.

Source: Ministry of Finance

Table 3: Discretionary Spending in the General Account, FY 1980-FY 1985

(in billions of yen and percentage change)

	FY 1980		FY 1981		FY 1982		FY 1983		FY 1984		FY 1985*	
Total Expenditures	Y43,681.4	10.1%	Y47,125.4	7.9%	Y47,562.1	0.9%	Y50,839.4	6.9%	Y51,513.4	1.3%	Y52,499.6	3.7%
Minus												
Debt Service and Transfers to Local Governments	12,443.7	20.8	14,693.8	18.1	14,442.2	-1.7	15,482.7	7.2	18,191.2	17.5	19,914.2	10.4
Equals												
Discretionary Spending	31,237.7	6.4	32,094.3	2.7	33,120.0	3.2	35,356.8	6.8	33,322.2	-5.8	32,585.4	-0.0

*Percentage changes for FY 1985 are based on the initial budget for FY 1984.

Source: Ministry of Finance

Table 4: Medium-Term Budget Projection, FY 1984-FY 1988

(in billions of yen and percentage change)

	FY 1984		FY 1985		FY 1986		FY 1987		FY 1988	
Payments										
Debt Service	Y9,155.1	11.7%	Y10,224.1	11.7%	Y12,930.0	26.5%	13,800.0	6.7%	Y14,550.0	5.4%
Transfers to Local Governments	8,886.4	21.5	9,690.1	9.0	10,330.0	6.6	11,140.0	7.8	12,010.0	7.8
General Expenditures	32,585.7	-0.1	32,585.4	-0.0	34,660.0	6.4	36,070.0	4.1	37,430.0	3.8
					[35,180.0	8.0	37,150.0	5.6	39,110.0	5.3]
Current Expenditures	24,654.9	1.1	24,951.3	1.2	26,910.0	7.9	28,250.0	5.0	29,530.0	4.5
					[27,310.0	9.5	29,100.0	6.6	30,860.0	6.0]
Capital Expenditures	7,930.8	-3.7	7,634.1	-3.7	7,750.0	1.5	7,820.0	0.9	7,900.0	1.0
					[7,870.0	3.1	8,050.0	2.3	8,250.0	2.5]
Total Payments	50,627.2	0.5	52,499.6	3.7	57,920.0	10.3	61,010.0	5.3	63,990.0	4.9
					[58,440.0	11.3	62,090.0	6.2	65,670.0	5.8]
Receipts										
Tax Revenues	34,596.0	7.1	38,550.0	11.4	41,290.0	7.1	44,240.0	7.2	47,400.0	7.2
Non-tax Revenues	3,351.2	-29.0	2,269.6	-32.3	2,370.0	4.4	2,530.0	6.5	2,690.0	6.5
Government Bonds	12,680.0	-8.0	11,680.0	-7.9	10,530.0	-9.8	9,380.0	-10.9	8,230.0	-12.3
Deficit Bonds	6,455.0	-5.2	5,730.0	-11.2	4,580.0	-20.1	3,430.0	-25.1	2,280.0	-33.5
Construction Bonds	6,225.0	-10.8	5,950.0	-4.4	5,950.0	0.0	5,950.0	0.0	5,950.0	0.0
Total Receipts	50,627.2	0.5	52,499.6	3.7	54,190.0	3.2	56,150.0	3.6	58,320.0	3.9
Shortfall (Total Payments minus Total Receipts)	--	--	--	--	3,730.0	--	4,860.0	--	5,670.0	--
					[4,250.0	--	5,940.0	--	7,350.0	--]
Current Expenditures	--	--	--	--	3,610.0	--	4,680.0	--	5,450.0	--
					[4,010.0	--	5,530.0	--	6,780.0	--]
Capital Expenditures	--	--	--	--	120.0	--	180.0	--	220.0	--
					[240.0	--	410.0	--	570.0	--]

Note: Figures in brackets allow for new stimulative spending.

Assumptions: For debt service costs, transfer of the required percentage of the outstanding debt to the sinking fund will be in effect after FY 1986; the national government will transfer to local governments 32 percent of national income, corporate and liquor taxes, which are expected to increase at the nominal rate of economic growth of 6.5 percent with an income elasticity of 1.2; overall tax revenues are based on nominal economic growth of 6.5 percent and an income elasticity of 1.1; and deficit bonds will be reduced by Y1,150 billion annually after FY 1986.

Source: Ministry of Finance

Appendix: Japan's National Tax Reforms, FY 1983-FY 1985

FY 1983

1. Repeal and Curtailment of Special Taxation Measures - A variety of special taxation measures on corporate income were repealed or curtailed, including moving up a repeal of the tax-free reserve for price fluctuations.

2. A Review of the Rate of Reserve for Bad Debts - The deductible allowance for the tax-free reserve for bad debts will be decreased for banks and insurance firms.

3. Measures Related to Basic Materials Industries Extraordinary Measures Law - New measures will be implemented to support the new basic industries legislation, including increasing to ten years from five years the period in which losses from scrapping capacity can be carried over.

4. Measures to Promote Machinery and Equipment Investment by Small and Medium Enterprises - A two-year special depreciation allowance let small firms apply a 30 percent depreciation rate to the overall value of new plant and equipment that exceeds the average capital investment for the past five years.

5. Revision in Stock Evaluation Methods for the Inheritance Tax - An heir of non-listed stocks can choose to use the similar-business-comparison tax system together with the net-asset-evaluation system. Previously only the latter method was available.

6. Revision of the Tax Credit for the Acquisition of a Home- While the fixed amount (Y17,000) tax credit was abolished, both the fixed rate of tax credit and the upper ceiling of the credit value were raised from 7 percent to 18 percent and from Y50,000 to Y150,000, respectively.

Estimated Revenue Effects of FY 1983 Reforms

(in billions of yen)

	First Year	Out Years
1. Special Taxation Measures	Y14.0	Y22.0
2. Bad Debt Reserve Rate	42.0	43.0
3. Small Business Investment Incentives	-22.0	-30.0
4. Housing Credits	-1.0	-2.0
Total	33.0	33.0

FY 1984

1. Individual Income Tax Reduction - The changes included: increasing the taxpayer, spouse and dependent exemptions from Y290,000 to Y330,000; exemptions for widows, students, senior citizens and the handicapped were raised from Y230,000 to Y330,000; the deduction on employment income was raised from Y500,000 to Y550,000; the tax schedule was revised by reducing the top rate to 70 percent from 75 percent, and raising the lowest rate to 10.5 percent from 10 percent.

2. Measures to Promote Investment - Small enterprises that invest in energy efficient equipment can take a special initial depreciation of 30 percent and a tax credit of 7 percent for two years. In addition, special incentives for "technopolis" regional development projects were instituted.

3. Measure to Finance Tax Reductions - The corporate income tax rates were raised for two years from 42 percent to 43.3 percent on undistributed profits and from 32 percent to 33.3 percent on distributed profits. Corporations were no longer allowed to postpone income tax payments. Provisions allowing corporations to carry back losses for up to two years were suspended for two years. Liquor taxes were raised. Luxury sport and consumer electronic goods became subject to the commodity tax. And automobile taxes were raised from 22.5 percent to 23 percent for standard passenger cars and from 17.5 percent to 18.5 percent for small passenger cars.

4. Tax Compliance Provisions - Self-employed individuals were required to follow stricter accounting and record-keeping rules.

5. Petroleum Tax Increase - The crude oil tax and the tax on certain petroleum products was set at 4.7 percent, up from 3.5 percent. Petroleum gas (including liquefied natural gas) was subject to a new tax of 1.2 percent.

Estimated Revenue Effects of FY 1984 Reforms

(in billions of yen)

	First Year	Out Years
1. Personal Income Tax Cut	Y-870.0	Y-765.0
2. Investment Incentives	-62.0	-71.0
3. Increases in Corporate, Liquor and Commodity Taxes	785.0	799.0
4. Changes in Corporate Tax Regulations	145.0	60.0
Total	-2.0	23.0
Petroleum Tax Increase (not counted in General Account)	67.0	134.0

FY 1985

1. Reduction of Tax-Exempt Corporate Retirement Reserves - The tax-free portion of corporate retirement reserves was reduced from 40 percent to 35 percent.

2. Increased Public and Non-Profit Corporate Taxes - The basic corporate tax rate for public and non-profit firms was raised from 26 percent to 35 percent.

3. Changes for Corporations Experiencing Current Deficits - Businesses operating in the red must defer for two years the refund of any unused credits gained from witheld income taxes.

4. Special Taxation Measures - The tax credit for research and development will be based on a three-year moving average of past expenses, bringing it into line with the U.S. system. Incentives for high technology small businesses were created. The FY 1983 small business investment incentive was abolished.

5. Entertainment Admission Tax - The taxable minimums on most entertainment admissions, including movie, theater and race tickets, were raised according to the type of event.

Estimated Revenue Effects of FY 1985 Reforms

(in billions of yen)

	First Year	Out Years
1. Reduced Bad Debt Reserve Deductible	Y200.0	Y185.0
2. Increased Rates for Public and Non-Profit Corporations	32.0	32.0
3. Refund Deferrals by Deficit Corporations	84.0	--
4. Special Taxation Measures		
Research and Development Credits	-13.0	-16.0
High Technology Small Business	-10.0	-14.0
Abolition of Small Business Investment Incentive	17.0	22.0
Others	10.0	9.0
5. Admissions Tax Minimum Increase	-4.0	-4.0
Total	316.0	214.0

Source: Ministry of Finance, Budget Bureau